

## The Tax policy of Georgia and the Possible Ways for Its Improvement

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**Abstract:** This paper aims to examine the tax policy of Georgia, because correctly chosen tax policy is very important to solve the main tasks of the state and promote its economic growth. Recently, due to the current situation, we believe that Georgian tax policy needs to be reformed and based on foreign experience. We present a research about changing tax policy of Georgia for years. Also, we think, that in order to achieve the main goals of the state, we should determine the optimal ratio between tax policy functions. In this paper discusses the types of taxes in Georgia. In our opinion, in Georgia, where the majority of population is under the poverty level, indirect taxes lowers the living standards even more. Indirect taxes will play a big role in forming the state budget revenues until it is replaced by direct taxes. The first chapter is devoted to the introduction. The second chapter includes a literature review. The third part is devoted to the methodology and characteristics of the used data. The following section are main part of the text, which includes research and discussion. The fifth chapter is dedicated to a conclusion.

**Key words:** taxes; tax policy; budget revenues; decentralization; tax differentiation

**JEL codes:** H2, H3, H7

### 1. Introduction

There is impossible some economy development and economic progress without the existence of a solid financial system during the market economy. The level of management and regulation of country's social-economic development depends on government's abilities to find out, make predictions and optimal calculates the amount of state necessary expenses and revenues, which are needed to finance these expenses. The main sources for budget revenues are taxes and we think that, correctly chosen tax policy is very important to solve the main tasks of the state and promote its economic growth.

This article aims to discuss the types of taxes in Georgia. Based on extant literature review, using different relevant documents, statistical information and analysis, we will try to review the regularities of tax policy, identify trends in the development of tax policy. We will discuss the implemented activities by governments in tax fields, the planned objectives for achievement the effective tax policy and to evaluate their prospects.

In this paper we review the Georgian tax policy in recent years. The result shows that, in Georgia, where the taxes mostly have fiscal function, state budget income increases on the base of indirect taxes. It is risky when the budget depends on import, since the world politics and international economic relations are unstable. In our opinion, in Georgia, where the majority of population is under the poverty level, indirect taxes lowers the living

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standards even more. Moreover, the government often has to reject the planned reforms, if these reforms can reduce the budget revenues, which means that a choice must be made between tax policy functions.

Based on foreign experience, we will try to create some recommendations for the optimization of tax policy, which may be useful for tax policy improvement seekers.

## **2. Literature Review**

We have reviewed the research literature: Bakhtadze L., Kakulia R. and Chikviladze M. (2007); Beshkenadze, Z. (2013); Kakulia R. (2012); Kakulia R., Bakhtadze L. and Djibuti A. (2010); Kikvadze N. (2010); Meskhia I. and Basaria R. (2001); Meskhia I. and Nikoleishvili O. (2002); Chikobava M. and Kakulia N. (2009).

The literature focuses on tax policy functions, the optimal alignment direct and indirect taxes, tax rate differentiations, fiscal decentralizations and foreign experience.

I decided to discuss about these issues jointly to define tax policy problems in Georgia and to find out possible ways for its improvement.

## **3. Research Methodology**

For research the tax policy of Georgia and to find out the possible ways for its improvement I use some statistical analysis, diagrams, analytical and synthetic methods, comparative methods. The data are taken on the base of Georgian and Foreign official websites.

## **4. The Main Part of the Text**

### **4.1 Taxes — as an Instrument Economic Growth or Delay**

In order to overcome social-economic development problems, the level of taxation in country should be comply the stage in which the economy is in. In particular, during the period of production growth the rates of taxes should be increase, which does not exclude the probability of their reducing for priority sectors (a restrictive fiscal policy). During a crisis tax rates should be reduced and make some tax privileges for manufacturers, in some cases, to determine the regressive rates of taxes. Some scientists believe that in a long-term perspective the tax reduction policies (stimulating tax policy) could expand the supply factors of production and growth of economic potential (Chiqobava & Kakulia, 2009, p. 255). Thus, taxes can be used as an instrument of economic growth or delay.

### **4.2 The Choice between Tax Policy Functions**

In order to achieve the main goals of the state, we should determine the optimal ratio between tax policy functions. During the choice between fiscal and regulatory functions, should be given an attention, that tax rate reduction (regulatory function) promote the country's economic growth, but it makes some problems for filling the budget with tax revenues (fiscal function). This situation often hinder state to implement the planned reforms. For example, there was planned to reduce the rates of income taxes up to 18% since 2013 year in Georgia, and after 2014 year the rates of income taxes would become 15%. This liberalization process of the income tax rates would significantly reduce the part of income, and these changes have not been implemented. Taxes have social function too. That means that taxes have to equalize the income of the various groups. The most unjustified taxes by socially fields are indirect taxes, because they make the same tax pressure on each member of the society. But

indirect taxes are more effective by fiscally fields, because they are not required administration and are accepted in budget regularly. Therefore, most of the developing and least developing countries prefer to indirect taxes. The fact that state revenues grow by reducing welfare of the population, indicates an inverse dependence between fiscal and social functions of taxes.

#### 4.3 The Optimal Ratio between Direct and Indirect Taxes and Georgian Tax Revenue Structure

To determine the optimal ratio between direct and indirect taxes is considered as an important indicator to make assessment the tax policy during specific analyzing period. According to the tax code of Georgia, to direct taxes belong: income tax, profit tax and property tax; value added tax, excise and import taxes are indirect taxes. In Georgia, in 2003-2014 years, the share of indirect taxes is larger than share of direct taxes in the tax revenue structure of the consolidated budget. For example, in 2003 year the share of indirect taxes in the tax revenue structure was 68% and direct taxes were 32%. In 2005 year the share of direct taxes was 28%. In 2010 year the share of indirect taxes was 58%, while direct taxes were 42%. It indicates that in 2010 year the tax weight was charged to customers more than suppliers. During 2011-2012 years the share of indirect taxes was 57% and direct taxes were 43%. However, in 2012 year the growth rate of direct taxes was bigger than the growth rate of indirect taxes, which was caused by 3.3% reducing imports. In 2013 year the share of direct taxes was 45%, and in 2014 year it was 42%.

The result we can see on Figure 1.

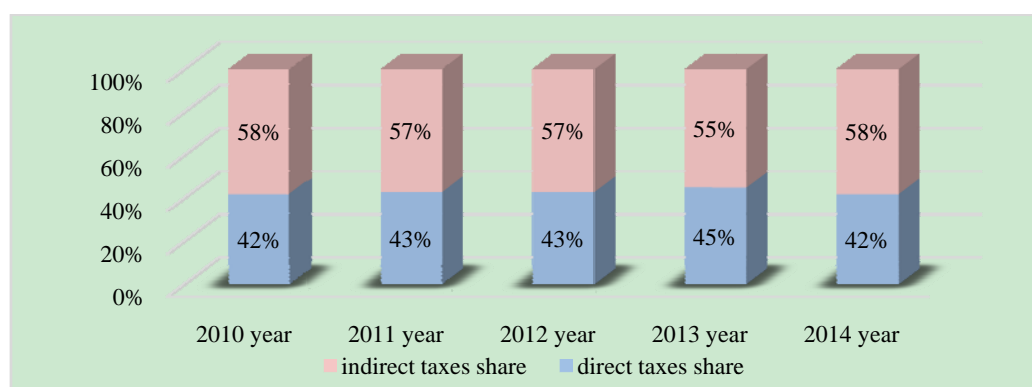


Figure 1 The Tax Revenue Structure of the Consolidated Budget in Georgia during 2010-2014 Years

Our analysis shows that the share of indirect taxes always exceeds the direct tax share in the structure of tax revenue of Georgian consolidated budget. This is considered as a negative trend, because high share of indirect taxes will be forcing manufacturer to cut production capacity, which is followed by job cuts and growth of unemployment. Indirect taxes will play a big role in forming the state budget revenues until it is replaced by income taxes, profit taxes and property taxes by the development of national economic, increasing revenue of population and forming tax policy.

In this regard there is not planned any changes in the near future. In 2015 year the state budget revenue is defined 7.95 billion GEL. It includes 7.4 billion GEL taxes, which means that filling the main part of the budget will plan by tax revenue. In addition, the VAT will be the largest part (47.4%) of tax revenue. The increase of indirect taxes is planned in 2015 years too (see the Figure 2).

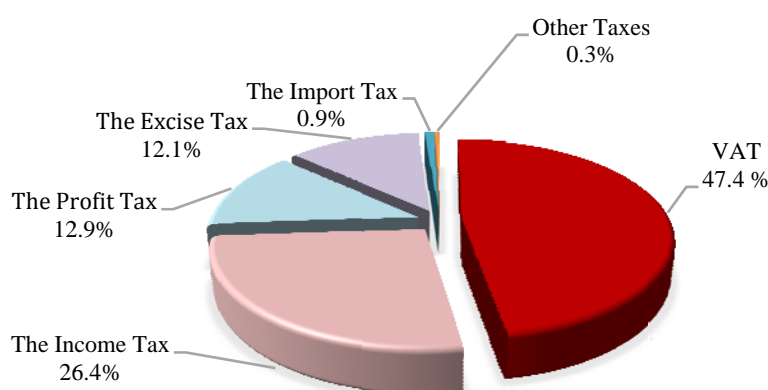


Figure 2 The Tax Revenue Structure 2015 (Plan)

#### 4.4 Foreign Experience (USA)

Georgian Tax policy needs to be reformed and based on foreign experience. For example, The USA, Canada, Japan and other developed countries preferred to direct taxes. In particular, in the USA the main source of tax revenues is income tax. For instance, in 2013 year 48% of USA's tax revenues was income tax. In 2015 years 37% of USA's budget will be income taxes and the VAT will be just 22%. It will be better, if Georgia use foreign experience and make changes in the tax policy for increasing direct taxes share, which improves tax policy.

#### 4.5 The Tax-free Minimum in Georgia

The introduction of tax-free minimum we can consider as a step forward for income distribution and reducing for social inequality in Georgia. In particular, an individual person, whose taxable income received as salary does not exceed 6000 GEL during the calendar year, is entitled to deduct tax-free minimum — 1800 GEL from income. In taxable income are not considered for income received as salary, which is exemption income tax based on tax code of Georgia. Untaxed minimum spreads only salary form of income. We think that it is necessary to spread this benefit of other revenues too, because one of the goals of tax policy is to striving for tax fairness.

#### 4.6 The Tax Differentiation (Foreign Experience)

We strongly believe that one of the ways to improve the tax policy is tax differentiation. The income tax of individual persons is differentiated in most developed and developing countries. In Georgia the income tax rate is 20%. In our opinion this is not fair, due to a sharp differentiation the wage rates. In many foreign countries, income tax is calculated not only from citizen's income, rather from his family's gross income, which means that this taxation method provides the employees numbers in family. By determining income tax the rates differentiation approach is used in developing countries too. This is testified by the fact, that in Moldova is used progressive tax rates. Specifically, the income before 25200 MDL is taxed with 7% and the income above 25200 MDL is taxed with 18% (<http://www.mf.gov.md/en/taxation>). To accomplish this, we believe that to develop tax policy Georgia, it needs making income tax rates different.

There are some differentiation of profit tax in foreign countries. On the one hand, the differentiation can be carried out by types of activities. For example, in France the agricultural profits are taxed at lower rates than the oil companies, the new established companies are exempt from profit taxes for 2 years. On the other hand, profit tax may be differentiated according to the volume of profits. For Example, the USA profit tax rate is progressive. We think that, it will be better to use both face differentiation and tax exemptions in Georgia to develop priority sectors.

Vertical fairness principle can use for other taxes too. For example, VAT differentiation-by increasing its rate on luxuries, make abilities the tax weight move to high-income individuals. VAT is differentiated in many foreign countries. Low rates are applied to the essentials. In some countries, such as Great Britain and Germany, agriculture and consumer goods are exempt from these taxes. Luxury goods, alcohol and cigarettes are taxed at a high rate. There is not a differentiated VAT in Georgia and its rate is 18%. We believe that, Georgia should use the tax differentiation, similar many other countries,. VAT differential tax rates will make the fiscal and stimulating functions stronger, which is reflected in the investment climate improvement in the country.

#### **4.7 The Lack of Fiscal Decentralization in Georgia and the Foreign Experience**

One of the problems, which has Georgian tax policy is the lack of fiscal decentralization, which is revealed in the formation of the local budget, because the major source of local budgets are transfers. After the processes, when in 2006 years profit taxes and in 2007 years income taxes came under the authority of the central government, compensated financial source became transfers. In 2008 year in the state budget financial assistance for self-government was determined 859.4 million GEL, including the equalization transfers 321.0 million GEL. In 2007 year the municipal became 526.3 million GEL, as a form income taxes. In fact, in 2008 year , they lost for its powers around 200.0 million GEL, which indicates the lack of fiscal decentralization.

Local budgets should have independent sources of income, equity income from general state taxes, which will contribute to the region's social-economic development. For example, in Germany is widely used taxes distribution practices between central and regional budgets. Income taxes divides by — 42.5%, 42.5% and 15% proportions in the central, land and local governance. France's central budget includes only 41.4% of value added tax and the 10.6% of income tax. Similar western advanced countries experience, we think, that during Georgian state budget formation, income distribution between central state and local budgets should base on the self-involved form by tax formation.

### **5. Conclusions**

Thus, tax policy is very important to solve the main tasks of the state and promote its economic growth. Although, in our country implemented some activities for liberalization and improvement tax policy, but the problems still exist. In Georgia, where the taxes mostly have fiscal function, state budget income increases on the base of indirect taxes. It is risky when the budget depends on import, since the world politics and international economic relations are unstable. Indirect taxes, are included in the products cost price, increases its prices. In our opinion, in Georgia, where the majority of population is under the poverty level, indirect taxes lowers the living standards even more.

From our point of view, the problem might be solved by the following ways:

- Change the ratio between direct and indirect taxes in order to increase the direct taxes share;
- Tax-exempt income should spread of other types of revenues too before 1800 GEL. This will protected horizontal fairness principle;
- Implement the fiscal decentralization. Local budgets should have independent sources of income, equity income from general state taxes, which will contribute to the region's social economic development.

Besides, we strongly believe that one of the ways to improve the tax policy is tax differentiation: to have the multi-level value added tax, profit tax, income tax and other taxes. This approach will stimulate the priority sectors of economy, encourage local manufacture and export sectors, improve the investment environment in the

country and etc. This will help the country to overcome the social-economic development problems.

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